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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 446

STAPLING MACHINES CO. ..... Appellant

vs.

A. H. STONE, CHAIRMAN STATE TAX COMMISSION ..... Appellee

BRIEF OF APPELLANT IN REPLY TO STATEMENT OF APPELLEE OPPOSING JURISDICTION AND MOTION TO DISMISS OR AFFIRM

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May it please the Court:

BRIEF IN SUPPORT OF PETITION FOR APPEAL

I.

STATEMENT OF FACTS AND ISSUES ON APPEAL

Appellant, Stapling Machines Co., is a Delaware corporation, domiciled in Rockaway, New Jersey, and is the owner of patents covering box-making machines and patented boxes and is engaged solely in the *licensing* of patent rights to licensees in the State of Mississippi. The company is *not* engaged in Mississippi in the *renting or leasing* of personal property and is engaged only in licensing the patents which it owns, all of which are located in the State of New Jersey.

The record on appeal will disclose that a license agreement was entered into between the licensor, Stapling Machines Co., Appellant in this case, and various licensees in Mississippi. The license agreements were all entered into in the State of New Jersey, *whereby the licensees agreed to pay to the licensor a royalty for the use of the patented machines amounting to two percent of the gross sales or fair market value, whichever was higher, and an additional two percent for the use of its patents to manufacture patented boxes.* There is no provision in the license agreement for the payment of rent, as such. As a corollary to this agreement, the licensee is required and does pay to the licensor one hundred percent of the value of the machine which is delivered to the licensee in the State of New Jersey and moved to the State of Mississippi under the direction and designation of the licensee, and the location of the machines is only for the convenience of the licensee. From that time forward, Stapling Machines Co., Appellant, has no control whatsoever over the machines except for the purpose of inspecting and sketching for study in connection with future patent improvements. The record will also disclose a Stipulation and Agreement to the effect that 90% of the royalty income was received by Appellant as royalty for use of its patents to manufacture patented boxes. (Article 6, Stipulation, R-44).

Title is retained in the machines by this licensor solely for the purpose of protecting its patent rights, as the company has been fully reimbursed for the expense of manufacture of the machines. The Stapling Machines Co., Appellant, is not present in Mississippi for any purpose. They have no offices, agents or employees of any kind in this State at any time, and they have not

qualified to do business in Mississippi. The license agreements are entered into in the State of New Jersey.

The pleadings in the record will show that under the license agreement all ad valorem taxes are paid by the licensee on the machines for protection by the State of Mississippi, and the record will further show that all taxes required by New Jersey, the State of domicile, are paid by the Appellant to that State. The Appellee in this case, the State Tax Commission, attempts to impose an Income Tax on this activity which they have admitted is wholly and completely in interstate commerce, and which does not have a business situs in Mississippi. Excerpts from the statute imposing the tax, which statute is shown in complete detail in Appendix "C" to the Statement as to jurisdiction, are as follows:

> Mississippi Code of 1942 Annotated, Sec. 9220-12. Net income of nonresident and foreign taxpayers.—(1) In the case of foreign corporations or of a non-resident or citizen of a foreign country, the following items of gross income shall be treated as income from sources within the state:
>
> (a) Interest on bonds, notes or other interest-bearing obligations, and the amount received as dividends if the evidence of ownership has acquired a business situs in this state, compensation for personal service or labor performed within the state; rentals or royalties from property or any interest in property within the state; and income from the operation, or ownership of any property within the state.
>
> (b) From the items of gross income specified herein there shall be deducted the expenses, losses, and other deductions properly apportioned, or allocated thereto, and a ratable part of any expense, losses, or other deductions which cannot be definitely allocated to some

item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the state.

The Tax Commission, in attempting to apply this tax did so in an arbitrary manner, without regard for the law including all of the income of the Appellant which was not supported by the law and the facts and constitutional limitations, and it was so held by the Court of original jurisdiction.

STATEMENT AS TO JURISDICTION

Appellant submits herewith its statement particularly disclosing the basis upon which the Supreme Court has jurisdiction on appeal to review the judgment of the Supreme Court of the State of Mississippi entered in this cause.

Opinion Below

The opinion of the Supreme Court of the State of Mississippi, which is the highest Court of this State, indicates that said Court has decided a Federal question of substance in a way not in accord with applicable decisions of this Court. 28 U.S.C. 1257 (2). The Supreme Court of Mississippi has decided that an undomesticated foreign corporation engaged in business exclusively in Interstate Commerce and whose income is confined to royalty income from an intangible asset (patents) located entirely outside the State of Mississippi must pay an Income Tax on such commerce, even though its patents do not have a business or commercial situs in Mississippi.

Jurisdiction

The Judgment of the Supreme Court of the State of Mississippi was entered on June 14, 1954, the plaintiff-appellant's suggestion of error was overruled July 23, 1954, a notice of appeal to the Supreme Court of the

United States was filed with the Clerk of the Supreme Court of the State of Mississippi on the 14th day of September, 1954. To invoke the jurisdiction of the Supreme Court of the United States to review this decision is confirmed by Title 28, U. S. Code, Section 1257 (2).

The following decisions sustain jurisdiction of the Supreme Court of the United States to review the judgment on direct appeal in this case:

Nippert v. City of Richmond, 327 US 416, 90 L ed 760
Davis v. Virginia, 236 US 697, 59 L ed 795
Caldwell v. State of North Carolina, 187 US 622, 47 L ed 336
Dozier v. State of Alabama, 218 US 124, 54 L ed 965
Craig v. Mills, 33 So. (2d) 801, 203 Miss 692
Crutcher v. Kentucky (1891) 141 US 47, 35 L ed 649
Webber v. Virginia (1880) 103 US 344, 26 L ed 565
Robbins v. Tax District of Shelby County, (Tenn) 120 US 489, 30 L ed 964
William G. Asher v. State of Texas, 128 US 129, 32 L ed 368
International Textbook Co. v. Pigg, 217 US 91, 54 L ed 678
Memphis Steam Laundry Cleaners, Inc. v. A. H. Stone, Chairman, State Tax Commission, S. Ct. 96 L ed 436
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The Precise Questions Involved

The questions involved in this case and presented to the Court for its decision are as to whether or not the Income Tax Act of the State of Mississippi, as provided in the Code of 1942, Section 9220-31, as amended by Mississippi Laws of 1944, Chapter 124, Section 1, violate Paragraph 3, Section 8, of the Constitution of the United

States providing that Congress shall have power to regulate commerce with foreign nations and among the several states and with the Indian Tribes, and as to whether or not such paragraphs violate Section (1) of the 14th Amendment to the Constitution of the United States providing that no state shall deprive any persons of life, liberty and property without due process of law nor deny to any person within its jurisdiction the equal protection of the law.

The Supreme Court of Mississippi held that the sections were valid and did not violate the commerce clause or the 14th Amendment to the Constitution of the United States. The Federal questions in this cause were properly, timely and fully raised by Stapling Machines Co. and squarely passed upon by the Mississippi Supreme Court.

Appellant, in its defense by Suggestion of Error, (as filed with the Record) before entry of judgment, stated as follows:

> "We respectfully submit, with deference, that this Court in reversing the judgment of the lower court committed grevious error, in that the judgment contravenes the commerce clause of the Constitution of the United States in that it violates Paragraph 3, Section 8 of the Constitution of the United States providing that Congress shall have power to regulate commerce with foreign nations and among the several states and with the Indian Tribes and also that said judgment violates Section 1 of the 14th Amendment to the Constitution of the United States providing that no state shall deprive any person of life, liberty and property without due process of law, nor deny to any person within its jurisdiction the equal protection of the law."

1. That the Stapling Machines Co. did not direct or send the machines into Mississippi but lessee was free to take them wherever they pleased subject to the conditions of the license agreement.

2. All taxes, including ad valorem, sales, income, are paid by the lessee in Mississippi, in accordance with the license agreement.

3. The company is not using tangible personal property in Mississippi, as the property is used by lessee in its own location, in its own direction, after paying in full for the property, legal title only being retained by lessor to protect the patent rights.

4. In the stipulation of facts, the Court will note that 90 percent of all boxes manufactured on which royalty is paid were covered by unexpired box patents, and only 10 percent by expired box patents. This in itself disproves the allocation of the royalty income by the state whereby the state presupposes that all of the income is from the renting of tangible personal property, and the assessment made against appellee is at the rate of 14.09% of its total net income throughout the United States, which percentage utilizes the entire gross income received by appellee from licensees in this state.

5. The Legislature of Mississippi cannot pass taxation legislation that will reach across the state borders to tax an intangible right located outside the state, and the Supreme Court of the United States has continuously voided such legislation.

6. The appellee is not present in Mississippi for any purpose, having nothing in the State on which the Tax Commission may take jurisdiction, the full

value of the machines having been paid for, thereby acquiring an equitable title by the lessees who are assuming all responsibility of ownership, care, protection and taxation.

7. Appellant continuously advises the court that the patents are located in this state, whereas they have never been in Mississippi for any purpose.

8. Appellee is only asking relief from taxation on intangible rights (patents) located in New Jersey.

9. The State of Mississippi grants the Appellee nothing, as the right to license its patents and enter into interstate contracts stems from the Federal Constitution and the Commerce Clause which guarantees it freedom from interference or burden by the State.

10. A statute of a state which undertakes the tax on property wholly beyond her jurisdiction or control conflicts with the Fourteenth Amendment to the Constitution of the United States.

That these points were timely and fully raised by Appellant, Stapling Machines Co., is verified by the opinion of the Court, which stated:

> "The petition did not attack the method of allocation of net income to Mississippi, but attacked the State's power and jurisdiction to tax any of the money received by taxpayer from the Mississippi lessees, other than certain minimum, asserted rental values of the machines located in this State."

By reference to the decision of the Supreme Court of the State of Mississippi, it will be noted that its decision was predicated on the charge and pleadings made by Appellant that the income taxing statute of the State of

Mississippi did not violate Paragraph 3, Section 8, of the Constitution of the United States (Commerce Clause), and, second, did not violate Section 1 of the 14th Amendment to the Constitution of the United States (Due Process Clause).

The Appellant in its defense by charge to the Supreme Court of the State of Mississippi, through its brief and arguments, contended these main points:

Point No. 1: That said income is royalty paid for the use of patented machines, the patents on which are located in the State of New Jersey, and that the situs of the patents follow the domicile of the owner under the doctrine of mobilia sequuntur personam.

Point No. 2: Appellee is not "engaging" or "continuing" within this state in the business of renting or leasing of tangible personal property. The licensing of the machines to the Mississippi licensee is wholly interstate commerce, and the taxing act herein is inapplicable because it violates the commerce clause of the United States Constitution.

Point No. 3: If any part of appellee's income from these machines is rental, then only that part which can be said to be the fair rental value should be taxed.

Point 9: The State of Mississippi grants Appellee nothing, as the right to license its patents and enter into interstate contracts stems from the Federal Constitution and the Commerce Clause which guarantees it freedom from interference or burden by the State.

Point 10: A statute of a state which undertakes the tax on property wholly beyond her jurisdiction or control conflicts with the Fourteenth Amendment to the Constitution of the United States.

See:

Fish vs. Kansas, 274 US 380, 71 L ed 1108;

New York Central and Hudson River Railroad Company vs. New York, 186 US 269, 46 L ed 1158;

Commonwealth Bank vs. Griffith, 14 Pet. (39 US) 56, 10 L ed 352;

Phoenix Insurance Company vs. Gardiner, 11 Wall (78 US) 204, 28 L ed 112;

Plymouth Coal Company vs. Pennsylvania, 232 US 531, 58 L ed 713;

Southwestern Railway Company vs. Arkansas, 235 US 350, 59 L ed 265;

Louisiana Railway & Navigation Co. vs. Berhman, 235 US 164, 59 L ed 175;

Saunders vs. Shaw, 244 US 317, 61 L ed 1163.

II.

A SUBSTANTIAL FEDERAL QUESTION IS INVOLVED IN THIS CAUSE

The facts in the case appear from the pleadings and testimony and are undisputed. (R. - 3). The Appellant's petition alleged that it was a foreign corporation organized under the laws of the State of Delaware but whose domicile and principal place of business and all offices and officers are located in Rockaway, New Jersey, and that it was engaged in licensing patented machines and patents covering different types of boxes made by said machine, and which patents are made the subject of license agreements with licensees in the State of Mississippi. That it has no offices, officers, agents, employees, representatives, and no place of business located in the State of Mississippi. All of its transactions are in interstate commerce, and all of the patents are located in New Jersey, and, therefore, not subject to income tax by the State. That all license agreements are entered into in the State of New Jersey, where patented machines are delivered to the licensee f.o.b. Rockaway, New Jersey, after having been paid the sum of one hundred percent of the cost.

The State Tax Commission has attempted to impose an Income tax as a condition precedent to entering into the license agreements with licensees in the State of Mississippi, and has cited the Stapling Machines Co. to appear and show cause why it should not be required to pay the Income taxes imposed by the Mississippi Code of 1942, as amended by Mississippi Laws of 1944, Chapter 124, Section 1.

Appellant filed with the State Tax Commission a comprehensive statement of the nature and scope of its

business in Mississippi and alleged that the imposition of the tax violates constitutional immunities in that the State had no jurisdiction to tax the income from the intangible patent rights, as they had no business situs within the state and also the state's statutory definition of "doing business" could not confer such jurisdiction; that its activities were wholly and completely in interstate commerce and therefore not subject to Income taxation by the state. The Commission disagreed with Appellant and entered an order sustaining the tax liability. (R-23).

Appellant appealed to the Chancery Court of the First Judicial District of Hinds County, Mississippi, raising these questions by its pleadings. (R 3-7). The Chancery Court reversed the Tax Commission and held Appellant not liable for the taxes, on the ground, as stated in the opinion, that:

> "The special assessment as made by the Commission in its order of February 6, 1953 is not supported by the law and the facts and that the State of Mississippi does not have jurisdiction to make such assessment." (R-104)

The Supreme Court of Mississippi reversed the Chancery Court and entered a final judgment dismissing Appellant's suit and the amount sued for for the year 1950.

The Supreme Court of Mississippi summarized in its opinion the undisputed facts, as follows:

> "The pertinent facts applicable to appellee-taxpayer are substantially the same as those outlined in the opinion in 71 So. 2d 205, and they will not be recited in detail here. The income tax here involved is broader: It taxes the net income from 'rentals or royalties from property or any interest in property within the State.'

"Appellee is a Delaware corporation with its principal offices in New Jersey. It leased under a written contract to certain persons in Mississippi certain box-making machines on which it held United States patents. The lessees by this instrument obtained the right to use the patented machines to make boxes, and the right to make patented boxes. Appellee retained title to the machines, and agreed to furnish repair parts, and its agents were granted access to the machines. The Mississippi lessees agreed to pay for the use of the machines a sum equal to four percent of the gross sales from patented boxes made under the agreement, and a sum equal to two percent of the gross sales of all other boxes not patented and made under the agreement. In addition, the Mississippi lessees had to pay as an initial consideration for the lease the cost of production of the machines . . .

"Under this arrangement, the Stapling Machines Co. in the year 1950 derived gross income from rents and royalties from Mississippi in the amount of $634,209.78. Applying the ratio between Mississippi gross income and the total gross receipts in the nation, to the total net income of appellee, the State Tax Commission allocated to appellee a 1950 net income from this State in the amount of $265,972.32. Appellee had previously reported taxable net income from Mississippi for 1950 of $23,317.50. This was based upon the allocation by appellee of 1950 income only from what it considered to be rent on the machines in Mississippi, and on that return it paid a 1950 state income tax of $182.92.

"The petition for appeal charged that taxpayer had never qualified to do business in Mississippi, that it had no offices or agents in the State, and was not doing

business within the State; that most, if not all, of the money received by taxpayer from Mississippi lessees for 1950 was royalty for the right to make and sell patented boxes; and that such royalty is not derived from property in Mississippi and is not subject to a state income tax. *The petition did not attack the method of allocation of net income to Mississippi, but attacked the State's power and jurisdiction to tax any of the money received by taxpayer from the Mississippi lessees, other than certain minimum, asserted rental values of the machines located in this State.* (Underscoring ours). On the hearing in the Chancery Court, much of the same testimony and exhibits in the sales tax case were introduced into the record. On August 22, 1953, the Chancery Court entered a decree vacating and setting aside the deficiency assessment of the Commission in its order of February 6, 1953. Apparently the trial court's decree was based upon the idea that this State did not have jurisdiction to make the assessment, and on the assumptions that appellee was not doing business in Mississippi, that money received by appellee from Mississippi lessees of its machines was royalty, and that income from royalty on machines located in this State is immune from state income tax.

"Appellee contends again that it is not engaged in doing business within Mississippi, but that issue was properly decided against it in the sales tax case. Appellee further says that the licensing of the machines to the Mississippi lessees is wholly Interstate Commerce, and that to impose the state income tax on the money paid for the leases is violative of the interstate commerce clause. However, in the sales tax case we held that the machines had obtained a business situs in the state apart from the domicile of their owner, and that they had become localized and divorced from

the stream of interstate commerce. (71 So. 2d 209-210). Appellee also argues that if any part of its income from these machines is rental, then only that part which can be said to be the fair rental value should be taxed. It then refers to the same testimony which was used in the record in the sales tax case, in which a real estate man and an accountant testified as to what they thought was a fair rental value of the machines used in Mississippi by lessees. That contention also was rejected in the sales tax case. It was there held that the *rental* which the sales tax statute made the basis of computation of that tax was two percent of gross income from patented and from unpatented boxes.

"The most substantial part of appellee's net income assessed by the Commission is derived from rent received by appellee for the use of the machines in this state, as was held in the sales tax case, 71 So. 2d 205, 207. Some of the assessed income constitutes income from royalties derived from the use in Mississippi of the patented machines. As to the latter, appellee apparently contends that the assessment is invalid because its patents are immune from taxation by any State other than that of the domicile of the taxpayer. This is beside the point. The income tax in question is not a tax on appellee's patents. It is a tax on income earned in Mississippi by the use in this state by appellee of its personal property."

The Court further stated that it was immaterial whether the income was royalty income from an intangible right, or rental income from the leasing of personal property, and that the State had jurisdiction to tax the income of the appellant, no matter what the circumstances of its earnings, whether the income was 10% rent and 90% royalty. Undoubtedly appellant is engaging in Mis-

sissippi wholly in interstate commerce to the extent that its patents are licensed from the State of New Jersey only, and for Mississippi to attempt to reach this income by taxation violates Section 1 of the 14th Amendment to the Constitution of the United States.

Briefly the Supreme Court of Mississippi held that Appellant must pay an income tax on the income from the intangible patent rights which are owned and located in the State of New Jersey and are made the subject of a license agreement in its office in New Jersey where the machines are delivered to the licensee.

The State is taxing not only that part which may be designated as rent but that part which has been stipulated to be royalty amounting to 90% of the Company's income, which income is royalty on patent rights for the manufacture of patented boxes.

That the Federal questions are substantial in this case cannot be doubted for the reason that it represents an attempt by the State to tax for the first time royalty income from patent rights, the situs of which is located outside of the taxing state, and the ruling of the Supreme Court of the State of Mississippi is to the effect that the State of Mississippi, Appellee in this case, has the right to tax royalty income from an intangible patent right, no matter where the patent may be located.

The authority cited by the Supreme Court of the State of Mississippi as being controlling, *Fox Film Corporation vs. Doyal*, 286 U. S. 123, 52 S. Ct. 546, 76 L. Ed 1010 (1932) has no relation to the problem before this Court, as the Appellant in this cause is not asserting an immunity to this taxation because the patents are instrumentalities of the Federal Government, but rather

because they are not present in Mississippi, and therefore, not subject to its jurisdiction.

In *Curry v. McCanless,* 307 U. S. 357, 83 L. Ed. 1339, the Court held that intangible income was subject to jurisdiction and taxation by two states for the reason that the evidence of ownership was located in the second state and that the ownership rights were being exercised within the jurisdiction of the second state, and, therefore, its ownership was amenable to the State laws and subject to State taxation; but here the evidence of ownership is not present in Mississippi and not subject to its jurisdiction.

Although the Supreme Court of the United States has held continuously since *Shaffer vs. Carter,* 252 US 37 that a state may impose an annual tax upon the net income derived by nonresidents from property owned by them *within the State* and from any business, trade or profession carried on by them *within its borders,* it may do so only if consistent with the Due Process Clause of the 14th Amendment to the Constitution of the United States.

In *Fox Film Corp. v. Doyal,* 286 U. S. 123, 52 S. Ct. 546, 76 L. Ed. 1010 (1932) held by the State to be controlling, Fox Film Corporation was a New York corporation engaged in the State of Georgia in the business of licensing copyrighted motion pictures. The State of Georgia assessed a tax for the privilege of engaging in that business in Georgia, measured by the gross receipts from royalties. The tax was "a direct charge upon the royalties." The court held for the first time that a tax upon the profits derived from copyrights is not a tax upon an instrumentality of the Federal government and is not immune from state taxation; and that in this aspect

royalties from copyrights were in the same position as royalties from the use of patent rights. The Court overruled *Long v. Rockwood*, 277 U. S. 142, 48 S. Ct. 463, 72 L. Ed. 824 (1928), holding to the contrary. In Long the court had invalidated a state assessment of income tax on royalties derived from patents.

Also, in *Laabs v. Wisconsin Tax Com.*, 218 Wis. 414, 261 No. W 404 (1935), which was decided after Doyal, the court upheld a Wisconsin tax upon the income derived by a Wisconsin resident from royalties on patents owned by the taxpayer. See also *Texas Co. v. Oklahoma Tax Com.*, 249 P. 2d 985, 989 (Okla. 1952); *Tirrell v. Johnston*, 293 U. S. 533, 55 S. Ct. 238 (1934).

In both of these cases, the Court will observe that the taxpayer was present in the State. In *Fox Film Corporation v. Doyal*, they were present in the State of Georgia with their copyrights, holding themselves out to be doing business within that State, whereas, in *Laabs v. Wisconsin*, the Court held that the Wisconsin tax was upon a Wisconsin resident residing in Wisconsin with his patent.

The Supreme Court of the State of Mississippi has reached its conclusion, as stated in the opinion of the Court:

> "That the box-making machines owned by Appellee have obtained a business situs in this State apart from the domicile of their owner, and, therefore, there is no interference with interstate commerce. The income which is taxed by the State of Mississippi is derived from the royalties based upon the personal property owned by the Appellee and located in Mississippi for local purposes."

Whereas, although the machines are located in the State of Mississippi and subject to such taxation as

would inure to the State from the assertion of a rental charge by appellant, the State is without authority to assess an income tax on the royalty income, which is well defined in the pleadings, agreements and proof, and which royalty income arises from patent licenses on the right to manufacture patented boxes, as well as royalty income from the right to manufacture non-patented boxes on patented machines.

The Court will distinguish this case from Stapling Machines Co. vs. Stone, 71 So. 2d 205, 106 S. Ct. Docket O. T. 1954. In that case the Tax Commission did not attempt to tax what they considered to be royalty income, eliminating that sum from the measure of assessment, whereas in the instant case the Tax Commission has included all income of Appellant, which income includes all moneys received not only from what was construed by the State to be rental income but royalty for the use of the patented machines and royalty from its use of its patents to manufacture patented boxes.

WHEREFORE, Appellant respectfully moves that the motion filed by the Appellee opposing jurisdiction and requesting this Court to dismiss Appellant's appeal or affirm the judgment of the Supreme Court of Mississippi be dismissed and that the appeal of Stapling Machines Co., Appellant in this cause, be considered on the record and the jurisdictional compliance.

Respectfully,

STAPLING MACHINES CO.,

By .....

Bernard Leonard Tigle, Jr.
Of Counsel for Appellant

CERTIFICATE

I, Bernard Leonard Tighe, Jr., Counsel for Appellant in the above styled cause, certify that I have this day delivered a copy of the above and foregoing Brief of Appellant in Reply to Statement of Appellee Opposing Jurisdiction and Motion to Dismiss or Affirm, to Honorable John E. Stone, attorney for Appellee, by leaving a copy thereof at his offices located in the State Office Building, Jackson, Mississippi. This the.....day of November, 1954.

BERNARD LEONARD TIGHE, JR.

BLEED THROUGH POOR COPY